REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL LEGISLATURE AND COUNCIL ON UGU DISTRICT MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of Ugu District Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2013, the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2012 (Act No. 5 of 2012) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer opinion

Property, plant and equipment (PPE)

4. I was unable to obtain sufficient appropriate evidence that management has accounted for all property plant and equipment, depreciation and accumulated depreciation for the current year due to the municipality not maintaining a proper fixed asset register. I was unable to confirm the carrying value, depreciation and accumulated depreciation by alternative means. Consequently, I was unable to determine whether any adjustment to the property plant and equipment stated at R2,06 billion (2012: R1,93 billion) in note 9 to the financial statements were necessary.

Payables

5. I was unable to obtain sufficient appropriate audit evidence that the provision for leave pay included for all leave days taken by employees due to deficiencies with the functioning of the system and not all leave days taken being captured. I was unable to confirm the provision for leave pay by alternative means. Consequently, I was unable to determine whether any adjustment to the provision for leave pay stated at R15,27 million (2012: R11,91 million) in note 16 to the annual financial statements were necessary.

6. I was unable to obtain sufficient appropriate audit evidence in support of the journal processed to project cost accrual. I was unable to confirm the project cost accrual by alternative means. Consequently, I was unable to determine whether any adjustment to project cost accrual

stated at R13,54 million (2012: R52,74 million) in note 16 to the financial statements, was necessary.

Revenue and receivables from exchange transactions

7. I was unable to obtain sufficient appropriate audit evidence that management has properly charged and accounted for all service charge revenue due to poor internal controls in the billing and estimation thereof. I was unable to confirm the service charge revenue by alternative means. Consequently, I was unable to determine whether any adjustment to service charges stated at R274,52 million in note 25 and the related receivables from exchange transactions stated at R101,54 million in note 3 to the financial statements were necessary.
8. I was unable to obtain sufficient appropriate audit evidence for other revenue due to unjustified corrections. I was unable to confirm the other revenue by alternative means. Consequently, I was unable to determine whether any adjustment to other revenue stated at R11,86 million in note 28 to the financial statements, were necessary.
9. I was unable to obtain sufficient appropriate audit evidence for the fair value adjustment of receivables from exchange transactions due to inconsistencies on the amounts when compared to the statement of financial position and statement of financial performance. I was unable to confirm the fair value adjustment by alternative means. Consequently, I was unable to determine whether any adjustment to interest earned stated at R18,38 million in note 27 to the financial statements, was necessary.

Revenue from non exchange transactions

10. I was unable to obtain sufficient appropriate audit evidence for the revenue from non exchange transactions due to the adjustments passed after year end. I was unable to confirm the fair value adjustment by alternative means. Consequently, I was unable to determine whether any adjustment to revenue from non exchange transactions stated at R590,98 million in note 23 to the financial statements, was necessary.

Receivables and revenue from non exchange transactions

11. I was unable to obtain sufficient appropriate audit evidence for receivables from exchange transactions due to lack of supporting documentation. I was unable to confirm the revenue from non exchange transaction by alternative means. Consequently, I was unable to determine whether any adjustment to non service debtors stated at R8,64 million in note 4 to the financial statements, was necessary.

Value Added Tax (VAT) receivable

12. I was unable to obtain sufficient appropriate audit evidence that management has properly accrued and accounted for all VAT Output and VAT input, due to poor internal controls in the revenue and creditors system. I was unable to confirm the service VAT receivable by alternative means. Consequently, I was unable to determine whether any adjustment to VAT receivable stated at R21,36 million in note 5 to the financial statements was necessary.

Unspent conditional grants (Prior period error)

13. I was unable to obtain sufficient appropriate audit evidence that management has properly accounted for all corrections to prior period errors relating to incorrect entries passed to conditional grants due to lack of supporting documentation and justification for amounts processed. I was unable to confirm the prior period error adjustment by alternative means.

Consequently, I was unable to determine whether any adjustment to unspent conditional grants stated at R51,51 million (2012: R100,15 million) in note 17 and prior period error disclosure note stated at R62,46 million in note 40 to the financial statements was necessary.

Commitments

14. I was unable to obtain sufficient appropriate audit evidence for capital commitments due to inadequate records and reconciliations. I was unable to confirm the commitments by alternative means. Consequently I was unable to determine whether any adjustments to commitments stated at R510,24 million as disclosed in note 48 to the financial statements was necessary.

Irregular expenditure

15. I was unable to obtain sufficient appropriate audit evidence for irregular expenditure due to poor internal controls within the supply chain management function. I was unable to confirm the irregular expenditure by alternative means. Consequently, I was unable to determine whether any adjustments to irregular expenditure stated at R43,96 million in note 46.3 to financial statements was necessary.

Cash flow statement

16. I was unable to obtain sufficient appropriate audit evidence for the amounts disclosed as part for net cash flow from operating activities due to the inconsistencies in amounts when compared to the statement of financial position and performance. I was unable to confirm the net cash flow from operating activities by alternative means. Consequently, I was unable to determine whether any adjustments to the net cash flow from operating activities stated at R224,53 million on the cash flow statements were necessary.

Accumulated surplus

17. I was unable to obtain sufficient appropriate audit evidence for accumulated surplus due to the inconsistencies in amounts when compared to the statement of financial position and performance. I was unable to confirm the accumulated surplus by alternative means. Consequently, I was unable to determine whether any adjustments to accumulated surplus stated at R1,87 billion in note 22 to financial statements was necessary.

Disclaimer of opinion

18. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

Emphasis of matters

19. I draw attention to the matters below. My opinion is not modified in respect of these matters

Significant uncertainties

20. With reference to note 52.3 to the financial statements, the municipality is the defendant in 13 lawsuits relating to non payments of contracts and breach of agreements amounting to R21,79 million. The ultimate outcome of the matter cannot presently be determined and no provision for any liability that may result has been made in the financial statements.

21. With reference to note 52.5 in the financial statements, employees of the municipality have not been paid according to the wage scales and rates in the South African Local Government Association (SALGA) Categorisation and job evaluation wage curves collective agreement. The municipality has not finalised job evaluations pending the outcome of the lawsuit by the union disputing the agreement. The amount of the obligation cannot be determined with sufficient reliability and no provision for any liability that may result has been made in the financial statements.

Material losses

22. As disclosed in note 47.9 to the financial statements, material losses amounting to R21,48 million and 11,91million kilolitres were incurred as a result of water losses.

Going concern

23. Note 58 to the financial statements indicates that the Ugu District Municipality unspent conditional grants were not cash backed by an amount of R38,54 million at 30 June 2013. These conditions, along with other matters as set forth in the accounting officer's report, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

Unauthorised expenditure

24. As disclosed in note 46.1 to the financial statements, unauthorised expenditure of R8,13 million was incurred as a result of expenditure exceeding approved budget for operating expenditure.

Fruitless and wasteful expenditure

25. As disclosed in note 46.2 to the financial statements, fruitless and wasteful expenditure of R809 680 was incurred as a result of interstest charges on late payment.

Additional matter

26. I draw attention to the matter below. My opinion is not modified in respect of to this matter.

Unaudited supplementary schedules

27. The supplementary information set out on pages XX to XX do not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

28. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

29. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.

30. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned development objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the *National Treasury Framework for managing programme performance information (FMPPI).*

    The reliability of the information in respect of the selected programmes is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

31. The material findings are as follows:

Usefulness of information

Presentation

Measures to improve performance not disclosed

32. Section 46 of the Municipal Systems Act 32 of 2000, requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Measures to improve performance for a total of 29% of the planned targets not achieved were not reflected in the annual performance report. This was due to the lack of review of reported performance information by senior management.

Reliability of information

Infrastructure and basic service delivery and Local economic development

33. The National Treasury *Framework for managing programme performance information (FMPPI)* requires that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets.

34. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of information presented with respect to Infrastructure and basic service delivery.

35. This was due to the fact that the institution could not provide sufficient appropriate evidence in support of the information presented with respect to the Infrastructure and basic service delivery and the institution's records not permitting the application of alternative audit procedures.

Compliance with laws and regulations

36. I performed procedures to obtain evidence that the municipality has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the general notice issued in terms of the PAA are as follows:

Strategic planning and performance management

37. The accounting officer of the municipality did not by 25 January assess the performance of the municipality during the first half of the financial year, as required by section 72(1)(a)(ii) of the MFMA.

38. The municipality did not have and maintain effective, efficient and transparent systems of financial and risk management and internal controls as required by section 62(1)(c)(i) of the MFMA.

39. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.

Annual financial statements

40. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of unspent grants, retentions and trade creditors identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a disclaimer audit opinion.

Procurement and contract management

41. Awards were made to providers who are in the service of the municipality in contravention of section 112(j) of the MFMA and SCM regulations 44. Furthermore the provider failed to declare that he/she was in the service of the municipality, as required by SCM regulation 13(c).

42. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded only to bidders who submitted a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

43. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality and did not to disclose such interest, as required by SCM regulation 46(2)(e).

44. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).

45. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2).

46. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to suppliers based on preference points that were allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.

Expenditure management

47. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.

48. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Asset management

49. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

Revenue management

50. An adequate management, accounting and information system which accounts for revenue, debtors and receipts of revenue was not in place, as required by section 64(2)(e) of the MFMA.

51. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.

52. Accounts for service charges were not prepared on monthly, as required by section 64(2)(c) of the MFMA.

Budget management

53. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

Conditional grants received

54. The municipality did not evaluate its performance in respect of programmes funded by the Municipal Systems Infrastructure Grant submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(5) of the Division of Revenue Act.

Consequence management

55. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.

56. The condoning of irregular expenditure was not approved by the appropriate relevant authority, in accordance with the requirements of sections 1 and 170 of the MFMA.

57. Council certified unauthorised, irregular, fruitless and wasteful expenditure as irrecoverable without conducting an investigation by council committee to determine recoverability of the expenditure, as required by section 32(2) of the MFMA.

58. The council did not always report cases of alleged irregular expenditure that constituted a criminal offence, as required by section 32(6) of the MFMA.

Human resource

59. The municipal manager and or senior managers directly accountable to the municipal manager did not sign performance agreements, as required by section 57(2)(a) Municipal Systems Act.

Internal control

60. I considered internal control relevant to my audit of the financial statements, performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for disclaimer of opinion, the findings on the performance report and the findings on compliance with laws and regulations included in this report.

Leadership

61. The accounting officer and management did not exercise effective oversight over policies and procedures regarding supply chain management, revenue and performance management to enable and support understanding and execution of internal control objectives, processes and responsibilities.

Financial and performance management

62. Systems and controls were not designed in a manner to prevent, detect and address risks that impact on financial and compliance reporting. In this regard, the accounting officer and management did not ensure that regular, accurate and complete financial and performance reports were prepared.

63. Management did not implement controls over the preparation, review and reconciliation of the financial statements against supporting schedules as well as the reported performance against predetermined objectives.

Governance

64. Adequate controls to address the risks identified as part of the risk assessment have not been implemented.

OTHER REPORTS

Investigations completed during the financial year

65. Eight investigations were completed regarding alleged fraudulent supply chain management practices.

Investigations in progress during the financial year

66. Five investigations were in progress regarding alleged dishonesty, assault and misuse of municipal vehicles.

Auditor - General

Pietermaritzburg

30 November 2013

AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence